

Keynote Speech at the 7th EU-ASIA Financial Services Dialogue

By Morita Tokio, Vice Minister for International Affairs

Thank you for having me here today.

It seems like only yesterday that ASIFMA held a physical event in Tokyo along with the APRC meeting in October 2019.

Since then, COVID-19 has completely changed the world. Even within the very conservative regulatory community, which is very different from the business world, everyone including me has become accustomed to virtual conferences like this.

Today, as the Chair of the IOSCO APRC, I would like to briefly introduce the APRC's ongoing discussions, especially the COVID-19 related work and the discussion on market fragmentation and cross-border regulation, which has remained one of the primary concerns among the APRC members. Through that explanation, I would like to briefly touch upon two emerging issues of fragmentation, that is, sustainable finance and data localization. To address those issues, I would emphasize the importance of trust among the regulators, and explain the mechanism that APRC is currently working on in that regard.

COVID-19

First, I would like to briefly explain the discussion related to COVID-19.

In March last year, a so-called "dash for cash" situation occurred in the market, which caused turmoil in the major markets. The analysis of the situation and measures to improve the resilience have been discussed at the FSB and the IOSCO Board level.

As the market function returned to normal and firms became more aware of the issue of solvency instead of liquidity, some companies raised funds from the capital markets. The APRC is in the process of setting up a new workstream to analyze whether the capital markets of Asian authorities functioned well during this phase, and what kind of support measures were taken by the government. As the COVID-19 issue moves towards the exit, we expect that the importance of capital vis-a-vis debts will be further closed up, and we hope that we can be of some assistance.

Furthermore, the lockdowns triggered by the pandemic have brought a variety of issues, including

- (1) problems with the operational resilience of firms;
- (2) problems with ensuring the effectiveness of monitoring by authorities;
- (3) compliance issues, such as inappropriate sales activities to retail investors; and
- (4) changes in the behavioral patterns of retail investors.

The Retail Market Conduct Task Force, a board-level task force co-chaired by Australia's ASIC, which is a member of the APRC, has issued an alert on the speculative investment behavior of retail investors and the associated conduct risks in the context of the COVID-19 situation.

The task force released a report last December that illustrates how COVID-19 has affected the behavior of firms and retail investors, based on the cases provided by the IOSCO members.

Fortunately, the APRC members have not had a major event like the case of GameStop in the US, but even before that, the APRC members reported at APRC meetings that retail investors were selling off lower risk assets and increasing their investments in higher risk assets through, for instance, online platforms. We shared concerns that vulnerable investors are turning to higher risk investments.

The GameStop case made it clear that the concerns already raised by regulators are real. The investment behavior of retail investors was also a major topic at this APRC meeting two days ago.

With the rapid development of financial digitization, the nature and form of financial transactions are changing dramatically. We will continue to pay close attention to these trends.

Market fragmentation and cross-border regulation

From now on, I would like to introduce one of the main agenda items of the APRC, the discussion on market fragmentation and cross-border regulation.

The APRC has been actively tackling the issue of cross-border regulations for some time now and having dialogues with the EU and US on the regulations. Notably with the EU, the annual EU-Asia Pacific Forum has been held continuously since 2016 and was held again this year, yesterday.

In this meeting, we exchanged views on the topics related to sustainable finance, digitalization, and cross-border regulations.

The APRC's discussion on cross-border regulation is part of the overall IOSCO work plan. Therefore, I would like to briefly introduce the IOSCO work as a whole and its background.

The first point is the background to why the issue of market fragmentation has been highlighted.

In the aftermath of the financial crisis, a number of regulatory reforms were implemented simultaneously in various sectors. This resulted in fragmentation due to differences in the regulations and its practical approaches, as well as differences in the timing of implementation. This has become a particularly important issue in the APRC member regions, which are sandwiched between the two major jurisdictions of Europe and the United States, and where capital markets are at different stages of development within the region.

Against this background, the IOSCO Follow-up Group on Market Fragmentation, which we call the Follow Up Group, FUG, published a report two years ago, which provided examples of unintended and potentially harmful fragmentation and ways to address it.

On that basis, IOSCO approved a plan for three workstreams to address fragmentation in the autumn of 2019. Specifically, the proposals include:

- first, fostering mutual understanding among the IOSCO members on the emerging issues in relation to cross-border regulations and related initiatives;
- second; a process for deference; and
- third, deepening supervisory cooperation.

IOSCO firstly initiated the second workstream to identify good practices for deference. IOSCO submitted a report to the G20 in June last year, summarizing high-level good practices that could be considered in processes of deference.

The use of deference is steadily growing, especially in the EU. In Japan, too, deference is used on margin requirements, benchmark regulation, and, while it is not widely known, financial statement requirements.

In addition to this, the two remaining workstreams mentioned earlier are currently underway in line with the IOSCO work plan.

One is the third workstream on supervisory cooperation. More specifically, to extract lessons learned from the framework of supervisory colleges and identifying good practices if possible. It is difficult to create one-size-fits-all regulations because regulations are formulated as part of the larger legal system of each country, and therefore it is difficult to eradicate the possibility of market fragmentation at the regulatory level. In such a case, it is important to mitigate the adverse effects by using deference frameworks described earlier or at the level of supervision and as a matter of operation. Supervisory colleges have been used in the context of prudential regulations, CCPs, and Credit Rating Agencies. The purpose of this work is to explore whether it can be further used in the securities sector in the future, based on the experience of its use so far.

The last one is the first workstream to share among the IOSCO members the issues related to cross-border regulations that are currently arising and ongoing initiatives.

IOSCO has a committee called the Affiliate Members Consultative Committee, or AMCC, which consists of exchanges, SROs, and others. The proposal calls for the AMCC to submit an annual report on evidence-based fragmentation cases to the FUG and the Board. Co-chairs of the FUG received this year's report in January.

In addition to input from industry through the AMCC, IOSCO's four regional committees, including the APRC, will conduct annual dedicated sessions to exchange views on existing or emerging fragmentation from a regional perspective, and the results would also be brought to the FUG and the Board for discussion.

At the APRC, this session took place in January this year. ASIFMA also participated in this meeting and provided very useful inputs based on the detailed report already published last year.

In the course of these efforts, significant concrete outcomes have been achieved. For example, the concerns around derivatives reforms with the EU authorities have disappeared to a large extent through discussions based on trust between the EU and Asian authorities. On the other hand, as the market environment changes, a variety of new issues have come to the forefront of discussion. For example, it was recognized that the issue of sustainable finance, and the different responses of various countries in terms of data protection and localization requirements are emerging issues that need to be closely monitored as they may cause harmful fragmentation in the future. I would like to make a few remarks on these new issues.

Sustainable Finance

Discussions on sustainable finance are taking place in a variety of venues, including at the jurisdictional and regional levels, among private entities and international organizations including IOSCO. This has raised the possibility of a new fragmentation.

The ASIFMA report indicates a lack of common taxonomy, inconsistencies in disclosure standards, and supervisory approaches to climate-related risks as issues that could cause fragmentation.

Anecdotally, there is quite a number of standards for the disclosure of sustainability-related information. Such situation is known as "alphabet soup." The use of different standards for disclosure by different countries and companies not only causes market fragmentation, but also reduces the comparability of disclosed information and the efficiency of resource allocation through capital markets.

As a Capital Market authority, more harmonization in disclosure standards is the preferred way forward, provided that usefulness for investors and burdens on issuers are properly considered. IOSCO decided at the February Board meeting to work toward globally consistent, comparable and reliable sustainability disclosure standards and to promote cooperation with standard setters such as the IFRS Foundation.

At the regional committee level, the Hong Kong SFC is also taking the lead in the work so that the voices of the Asian authorities would be reflected in this Board-level initiative.

Although various stakeholders take various approaches in terms of contents and intensities, they all share the same ultimate goal of achieving a sustainable society. In this process, we believe that we can also address the possibility of market fragmentation by engaging diverse stakeholders and discussing at various levels.

APAC Financial Markets in the era of uncertainty

Next, I would like to briefly touch on the issue of data localization.

The Asian market is expected to become increasingly important in the future. Asia is one of the fastest growing regions in the world. The demand for funds for infrastructure is expected to be enormous. Furthermore, with the development of the middle class, the markets for fund management business and life insurance are expected to expand significantly. This is a financial market with great potential on a global scale.

It is important not only for the Asian region but also for the global economy to ensure stability and resilience in the Asian markets. We believe that the problems brought about by COVID-19 have raised the importance of strengthening the hub network of financial centers in Asia. It is important for financial hubs to be able to substitute and complement each other's functions in the event of a disaster, cyber-attack, geopolitical risk or COVID-19.

A distributed but coordinated hub network should be underpinned by frictionless data flow between financial centers. At the ASIFMA online event held on February 25, participants indicated that data is the most important issue. The excessive requirements for data localization will not only increase costs but also increase cybersecurity vulnerabilities if each location is required to have its own localized systems. Ensuring cross-border data flow with trust is essential for effective risk and customer management, including AML/CFT.

Other important issues to be discussed to address market fragmentation may include operational resilience. I understand that ASIFMA has recently issued a

proposal on principles for public cloud regulation. It is essential to sort out various approaches and perspectives on these matters among authorities. The discussion paper on outsourcing published by the FSB in November last year emphasizes the importance of a mapping exercise to understand the current status of outsourcing and third party relationships.

At the same time, there are some difficult issues regarding the handling of data, such as personal data and privacy issues, and even economic security. It is indeed a high-hanging fruit, but on the other hand, it is certainly not a problem that can be left unaddressed.

Importance of trust among authorities

Trust among authorities is crucial in dealing with these new types of market fragmentation issues. When some functions of the domestic firm are delegated across borders, information on activities in other jurisdictions must be obtained in order to supervise the firm effectively. At the IOSCO level, the IOSCO MMOU exists as a multi-jurisdictional framework for the exchange of information on law enforcement. However, there is currently no multi-jurisdictional framework for the purpose of day-to-day information exchange for supervision. Therefore, it is key to establish trust among authorities and enable the smooth exchange of information on supervision.

The IOSCO APRC is continuing to study a framework for smoother exchange of supervisory information in the region. Specifically, we are continuing to study the possibility of developing a comprehensive supervisory MMoU framework for the Asian region.

The work of supervisory colleges, which is the third workstream in the FUG, is also important in terms of information sharing backed by trust among authorities. Supervisory colleges are an excellent mechanism to bring together the relevant authorities of supervised firms operating in multiple jurisdictions to understand not only the actual situation of the firm, but also each authority's interests and concerns on the issues regarding the status of the current regulatory framework and its practice. The APRC has subordinate forums at the level of the person in charge of the day-to-day practice in the field, in which participants can exchange opinions and concerns. In addition, discussions are currently underway to create a framework

for discussion and exchange of opinions at the top level, that is, the commissioner or CEO level of the regulatory authorities.

The two emerging issues that I have just introduced are areas where the EU is leading the world and making pioneering efforts. In addition to cooperation among Asian authorities, I believe it is important to learn from the EU authorities about their efforts, and to have sincere discussions with Asian authorities if there is a risk of misunderstanding.

Conclusion

In conclusion, the market fragmentation is a constant challenge that occurs in various fields now and in the future. I hope that through the discussions at the APRC and IOSCO as a whole, the jurisdictions that make up the Asian capital markets will complement each other and create an open and resilient system as a whole, providing public goods to the world.

To this end, the continuous input from everyone here is indispensable. We look forward to close communication and collaboration. I would like to ask for your continued cooperation.